C/2024/6821

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COUNCIL RECOMMENDATION

of 21 October 2024

on economic, budgetary, employment and structural policies of Latvia

(C/2024/6821)

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Article 121(2) and Article 148(4) thereof,

Having regard to Regulation (EU) 2024/1263 of the European Parliament and of the Council of 29 April 2024 on the effective coordination of economic policies and on multilateral budgetary surveillance and repealing Council Regulation (EC) No 1466/97 ([1]), and in particular Article 3(3) thereof,

Having regard to the recommendation of the European Commission,

Having regard to the resolutions of the European Parliament,

Having regard to the conclusions of the European Council,

Having regard to the opinion of the Employment Committee,

Having regard to the opinion of the Economic and Financial Committee,

Having regard to the opinion of the Social Protection Committee,

Having regard to the opinion of the Economic Policy Committee,

Whereas:

(1) Regulation (EU) 2021/241 of the European Parliament and of the Council ([2]), which established the Recovery and Resilience Facility ('the Facility'), entered into force on 19 February 2021. The Facility provides financial support to the Member States for the implementation of reforms and investments, entailing a fiscal impulse financed by the Union. In line with the priorities of the European Semester for economic policy coordination, the Facility helps achieve the economic and social recovery and implement sustainable reforms and investments, in particular reforms and investments to promote the green and digital transitions and to make the Member States' economies more resilient. It also helps strengthen public finances and boost growth and job creation in the medium and long term, improve territorial cohesion within the Union and support the continued implementation of the European Pillar of Social Rights.

(2) Regulation (EU) 2023/435 of the European Parliament and of the Council ([3]) ('the REPowerEU Regulation'), which was adopted on 27 February 2023, aims to phase out the Union's dependence on Russian fossil-fuel imports. This would help achieve energy security and diversify the Union's energy supply, while increasing the uptake of renewables, energy storage capacities and energy efficiency. Latvia added a new REPowerEU chapter to its national recovery and resilience plan in order to finance key reforms and investments that will help achieve the REPowerEU objectives.

([1]) OJ L, 2024/1263, 30.4.2024, ELI: http://data.europa.eu/eli/reg/2024/1263/oj.

([2]) Regulation (EU) 2021/241 of the European Parliament and of the Council of 12 February 2021 establishing the Recovery and Resilience Facility (OJ L 57, 18.2.2021, p. 17, ELI: http://data.europa.eu/eli/reg/2021/241/oj).

([3]) Regulation (EU) 2023/435 of the European Parliament and of the Council of 27 February 2023 amending Regulation (EU) 2021/241 as regards REPowerEU chapters in recovery and resilience plans and amending Regulations (EU) No 1303/2013, (EU) 2021/1060 and (EU) 2021/1755, and Directive 2003/87/EC (OJ L 63, 28.2.2023, p. 1, ELI: http://data.europa.eu/eli/reg/2023/435/oj).

(3) On 16 March 2023, the Commission issued a communication entitled 'Long-term competitiveness of the EU: looking beyond 2030', in order to inform policy decisions and create the framework conditions for increasing growth. The communication frames competitiveness in terms of nine mutually reinforcing drivers. Among those drivers, access to private capital, research and innovation, education and skills, and a functioning single market emerge as paramount policy priorities for reform and investment to address current productivity challenges as well as to build up the long-term competitiveness of the Union and its Member States. On 14 February 2024, the Commission issued a communication entitled 'The 2024 Annual Single Market and Competitiveness Report'. That communication details the competitive strengths and challenges of the European single market, tracking yearly developments according to the nine competitiveness drivers identified.

(4) On 21 November 2023, the Commission adopted the 2024 Annual Sustainable Growth Survey, marking the start of the 2024 European Semester. On 22 March 2024, the European Council endorsed the priorities of the 2024 Annual Sustainable Growth Survey, which are centred around the four dimensions of competitive sustainability. On 21 November 2023, on the basis of Regulation (EU) No 1176/2011 of the European Parliament and of the Council ([4]), the Commission also adopted the 2024 Alert Mechanism Report, in which it did not identify Latvia as one of the Member States that may be affected, or may be at risk of being affected, by imbalances and for which an in-depth review would be needed. On the same date, the Commission adopted an opinion on the 2024 draft budgetary plan of Latvia. The Commission also adopted a recommendation for a Council recommendation on the economic policy of the euro areaand a proposal for the 2024 Joint Employment Report, which analyses the implementation of the Employment Guidelines and the principles of the European Pillar of Social Rights. The Council adopted the Recommendation on the economic policy of the euro area ([5]) ('the 2024 Recommendation on the euro area') on 12 April 2024 and the Joint Employment Report on 11 March 2024.

(5) On 30 April 2024, the Union's new economic governance framework entered into force. The framework includes the new Regulation (EU) 2024/1263 on the effective coordination of economic policies and multilateral budgetary surveillance, the amended Council Regulation (EC) No 1467/97 ([6]) on speeding up and clarifying the implementation of the excessive deficit procedure, and the amended Council Directive 2011/85/EU ([7]) on requirements for the budgetary frameworks of Member States. The objectives of the new economic governance framework are to promote sound and sustainable public finances, sustainable and inclusive growth and resilience through reforms and investments, and prevent excessive government deficits. The new economic governance framework also promotes national ownership and has a greater medium-term focus, combined with more effective and coherent enforcement. Each Member State has to submit to the Council and to the Commission a national medium-term fiscal-structural plan. A national medium-term fiscal-structural plan contains the fiscal, reform and investment commitments of a Member State, covering a planning horizon of 4 or 5 years, depending on the regular length of the national legislative term. The net expenditure ([8]) path in the national medium-term fiscal-structural plans has to comply with the requirements of Regulation (EU) 2024/1263, including the requirements to put or keep general government debt on a plausibly downward path by the end of the adjustment period, or for it to remain at prudent levels below 60 % of gross domestic product (GDP), and to bring and/or maintain the general government deficit below the 3 %-of-GDP Treaty reference value over the medium term. Where a Member State commits to a relevant set of reforms and investments in accordance with the criteria set out in Regulation (EU) 2024/1263, the adjustment period can be extended up to 3 years. For the purpose of supporting the preparation of those national medium-term fiscal-structural plans, on 21 June 2024, the Commission published guidance on the information to be provided by Member States in their national medium-term fiscal-structural plans and in their annual progress reports. In accordance with Articles 5 and 36 of Regulation (EU) 2024/1263, the Commission transmitted to the Member States reference trajectories and technical information, where applicable. Member States have to submit their national medium-term fiscal-structural plans by 20 September 2024, unless the Member State and the Commission agree to extend the deadline by a reasonable period of time. In accordance with their national legal

([4]) Regulation (EU) No 1176/2011 of the European Parliament and of the Council of 16 November 2011 on the prevention and correction of macroeconomic imbalances (OJ L 306, 23.11.2011, p. 25, ELI: http://data.europa.eu/eli/reg/2011/1176/oj).

([5]) Council Recommendation of 12 April 2024 on the economic policy of the euro area (OJ C, C/2024/2807, 23.4.2024, ELI: http://data.europa.eu/eli/C/2024/2807/oj).

([6]) Council Regulation (EC) No 1467/97 of 7 July 1997 on speeding up and clarifying the implementation of the excessive deficit procedure (OJ L 209, 2.8.1997, p. 6, ELI: http://data.europa.eu/eli/reg/1997/1467/oj).

([7]) Council Directive 2011/85/EU of 8 November 2011 on requirements for budgetary frameworks of the Member States (OJ L 306, 23.11.2011, p. 41, ELI: http://data.europa.eu/eli/dir/2011/85/oj).

([8]) Net expenditure as defined in Article 2, point (2), of Regulation (EU) 2024/1263: 'net expenditure' means government expenditure net of (i) interest expenditure, (ii) discretionary revenue measures, (iii) expenditure on programmes of the Union fully matched by revenue from Union funds, (iv) national expenditure on co-financing of programmes funded by the Union, (v) cyclical elements of unemployment benefit expenditure, and (vi) one-offs and other temporary measures.

frameworks, Member States may debate their draft medium-term plans with their national parliaments, may ask the independent fiscal institutions to issue an opinion, and may conduct a consultation of social partners and other national stakeholders.

(6) In 2024, the European Semester continues to evolve in line with the implementation of the Facility. The full implementation of the recovery and resilience plans remains essential for delivering the policy priorities under the European Semester, as the plans help effectively address all or a significant subset of challenges identified in the relevant country-specific recommendations issued in recent years. The 2019, 2020, 2022 and 2023 country-specific recommendations remain equally relevant for the recovery and resilience plans which have been revised, updated or amended in accordance with Articles 14, 18 and 21 of Regulation (EU) 2021/241.

(7) On 30 April 2021, Latvia submitted its national recovery and resilience plan to the Commission, in accordance with Article 18(1) of Regulation (EU) 2021/241. Pursuant to Article 19 of Regulation (EU) 2021/241, the Commission assessed the relevance, effectiveness, efficiency and coherence of the recovery and resilience plan, in accordance with the assessment guidelines set out in Annex V to that Regulation. On 13 July 2021, the Council adopted its Implementing Decision on the approval of the assessment of the recovery and resilience plan for Latvia ([9]), which was amended on 8 December 2023 pursuant to Article 18(2) of Regulation (EU) 2021/241 to update the maximum financial contribution for non-repayable financial support, as well as to include the REPowerEU chapter ([10]). The release of instalments is conditional on the adoption of a decision by the Commission, in accordance with Article 24(5) of Regulation (EU) 2021/241, stating that Latvia has satisfactorily fulfilled the relevant milestones and targets set out in the Council Implementing Decision. Satisfactory fulfilment presupposes that the achievement of preceding milestones and targets has not been reversed.

(8) On 14 May 2024, Latvia submitted its 2024 National Reform Programme and, on 30 April 2024, its 2024 Stability Programme, in line with Article 4(1) of Council Regulation (EC) No 1466/97 ([11]).

(9) On 19 June 2024, the Commission published the 2024 country report for Latvia. It assessed Latvia's progress in addressing the relevant country-specific recommendations adopted by the Council between 2019 and 2023 and took stock of Latvia's implementation of the recovery and resilience plan. On the basis of that analysis, the country report identified gaps with regard to those challenges that are not addressed or only partially addressed by the recovery and resilience plan, as well as new and emerging challenges. It also assessed Latvia's progress in implementing the European Pillar of Social Rights and in achieving the Union headline targets on employment, skills and poverty reduction, as well as progress in achieving the United Nations Sustainable Development Goals.

(10) According to data validated by Eurostat, Latvia's general government deficit decreased from 4,6 % of GDP in 2022 to 2,2 % in 2023, while the general government debt rose from 41,8 % of GDP at the end of 2022 to 43,6 % at the end of 2023.

(11) On 12 July 2022, the Council recommended ([12]) that Latvia takes action to ensure in 2023 that the growth of nationally financed primary current expenditure is in line with an overall neutral fiscal policy stance ([13]), taking into account continued temporary and targeted support to households and firms most vulnerable to energy price hikes and to people fleeing Ukraine. Latvia was recommended to stand ready to adjust current spending to the evolving situation. Latvia was also recommended to expand public investment for the green and digital transitions, and for energy security taking into account the REPowerEU initiative, including by making use of the Facility and other Union funds. In 2023, according to the Commission estimates, the fiscal stance ([14]) was expansionary, by 0,5 % of GDP, in a context of high inflation. The growth in nationally financed primary current expenditure (net of

([9]) ST 10157/21 INIT; ST 10157 ADD 1.

([10]) Council Implementing Decision of 8 December 2023 amending the Implementing Decision of 13 July 2021 on the approval of the assessment of the recovery and resilience plan for Latvia (ST 15569/23; ST 15569/23 ADD 1).

([11]) Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies (OJ L 209, 2.8.1997, p. 1, ELI: http://data.europa.eu/eli/reg/1997/1466/oj).

([12]) Council Recommendation of 12 July 2022 on the 2022 National Reform Programme of Latvia and delivering a Council opinion on the 2022 Stability Programme of Latvia (OJ C 334, 1.9.2022, p. 112.).

([13]) According to the Commission's 2024 spring forecast, the medium-term potential output growth of Latvia in 2023, which is used to measure the fiscal stance, is estimated at 7,6 % in nominal terms, based on the 10-year average real potential growth rate and the 2023 GDP deflator.

([14]) The fiscal stance is defined as a measure of the annual change in the underlying budgetary position of the general government. It aims to assess the economic impulse stemming from fiscal policies, both those that are nationally financed and those that are financed by the Union budget. The fiscal stance is measured as the difference between (i) the medium-term potential growth and (ii) the change in primary expenditure net of discretionary revenue measures (and excluding temporary emergency measures related to the COVID-19 crisis) and including expenditure financed by non-repayable support (grants) under the Facility and other Union funds.

discretionary revenue measures) in 2023 provided an expansionary contribution to the fiscal stance of 1,1 % of GDP. This includes the 0,4 %-of-GDP reduction in the cost of the targeted emergency support measures for households and firms most vulnerable to energy price hikes. The expansionary contribution of nationally financed net primary current expenditure in 2023 was therefore not due to the targeted emergency support to households and firms most vulnerable to energy price hikes. The expansionary growth in nationally financed primary current expenditure (net of discretionary revenue measures) was driven by increases in public sector wages and social benefits. In sum, the projected growth of nationally financed primary current expenditure in 2023 was not in line with the Council Recommendation of 12 July 2022. Expenditure financed by grants under the Facility and other Union funds amounted to 1,5 % of GDP in 2023. Nationally financed investment amounted to 3,3 % of GDP in 2023, with an annual decline of 0,1 percentage point from 2022. Latvia financed additional investment through the Facility and other Union funds. It financed public investment for the green and digital transitions and for energy security, such as the purchase of electric vehicles for public transport, the improvement of the energy efficiency of multi-apartment buildings and business properties, the modernisation of the electricity transmission and distribution networks, the centralisation of the governance of digital platforms and systems in the public sector, the development of digital skills and the digitalisation of processes in businesses, the development of broadband infrastructure, and the fostering of digitalisation in the education sector. That public investment is largely funded by the Facility and other Union funds.

(12) In the 2024 Stability Programme, the macroeconomic scenario underpinning the budgetary projections projects real GDP growth at 1,4 % in 2024 and 2,9 % in 2025, while projecting inflation measured by the harmonised index of consumer prices (HICP) at 1,6 % in 2024 and 2,5 % in 2025. The general government deficit under current policies ([15]) in the 2024 Stability Programme is projected to increase to 2,9 % of GDP in 2024 and decline to 2,7 % of GDP in 2025, while the general government debt-to-GDP ratio is set to increase to 45,2 % by the end of 2024 and 46,3 % by the end of 2025. After 2025, the general government deficit is projected to decrease to 2,2 % of GDP in 2026, 2,0 % in 2027 and 1,7 % in 2028. Therefore, the general government balance is planned to remain below the 3 %-of-GDP Treaty reference value over the programme horizon. In turn, after 2025, the general government debt-to-GDP ratio is projected to decrease to 46,2 % in 2026, increase to 48,8 % in 2027 and decrease to 48,2 % in 2028.

(13) The Commission's 2024 spring forecast projects real GDP to grow by 1,7 % in 2024 and 2,6 % in 2025, and inflation measured by HICP to stand at 1,6 % in 2024 and 2,0 % in 2025.

(14) The Commission's 2024 spring forecast projects a government deficit of 2,8 % of GDP in 2024, while the general government debt-to-GDP ratio is set to increase to 44,5 % by the end of 2024. In 2024, the impact of the complete phasing-out of energy-related measures by the end of 2023 will be more than offset by additional expenditure on public wage increases for teachers and administration, healthcare and education, as well as supplementary payments to pensioners. The development of technical infrastructure on the country's border will contribute to an increase in public investment expenditure. The introduction of corporate income tax advance payments in the financial sector and an increase in the rates for several excise products and in dividend payments from state-owned companies are expected to yield a moderate increase in revenue. According to the Commission's estimates, the fiscal stance is projected to be expansionary by 0,9 % of GDP in 2024.

(15) Expenditure amounting to 1,6 % of GDP is expected to be financed by non-repayable support ('grants') under the Facility in 2024, compared to 0,4 % of GDP in 2023, according to the Commission's 2024 spring forecast. Expenditure financed by grants under the Facility will enable high-quality investment and productivity-enhancing reforms without a direct impact on the general government balance or debt of Latvia.

(16) On 14 July 2023, the Council recommended ([16]) that Latvia ensure a prudent fiscal policy, in particular by limiting the nominal increase in net nationally financed primary expenditure ([17]) in 2024 to not more than 3,0 %. When executing their 2023 budgets and preparing their draft budgetary plans for 2024, Member States were invited to take

([15]) The 2024 Stability Programme states that according to current policies the budget deficit in 2025 is forecast to be 0,5 percentage points higher than the deficit target in the 2024 Stability Programme. The 2024 Stability Programme does not include any details on policy measures to be taken in order to ensure compliance with deficit targets.

([16]) Council Recommendation of 14 July 2023 on the 2023 National Reform Programme of Latvia and delivering a Council opinion on the 2023 Stability Programme of Latvia (OJ C 312, 1.9.2023, p. 125.).

([17]) Net primary expenditure is defined as nationally financed expenditure net of (i) discretionary revenue measures, (ii) interest expenditure, (iii) cyclical unemployment expenditure, and (iv) one-offs and other temporary measures.

into account that the Commission would propose to the Council the opening of deficit-based excessive deficit procedures on the basis of the outturn data for 2023. According to the Commission's 2024 spring forecast, Latvia's net nationally financed primary expenditure is projected to increase by 4,9 % in 2024, which is above the recommended maximum growth rate. This excess spending over the recommended maximum growth rate in net nationally financed primary expenditure corresponds to 0,7 % of GDP in 2024. However, net primary expenditure in 2023 was lower than expected at the time of the Council Recommendation of 14 July 2023 (by 0,9 % of GDP). As the recommendation for 2024 was formulated as a growth rate, the assessment of compliance also needs to take into account the base effect from 2023. Had net primary expenditure in 2023 been the same as expected at the time of the Council Recommendation of 14 July 2023, the resulting growth rate of net primary expenditure in 2024 would have been below the recommended growth rate by 0,2 % of GDP. Overall, net nationally financed primary expenditure is assessed as being at risk of not being fully in line with what was recommended by the Council.

(17) Moreover, the Council recommended that Latvia take action to wind down the emergency energy support measures in force, using the related savings to reduce the government deficit, as soon as possible in 2023 and 2024. The Council further recommended that, if renewed energy price increases necessitate new or continued support measures, Latvia ensure that such support measures are targeted at protecting vulnerable households and firms, are fiscally affordable, and preserve incentives for energy savings. According to the Commission's 2024 spring forecast, the net budgetary cost ([18]) of emergency energy support measures is estimated at 1,0 % of GDP in 2023 and 0,0 % of GDP in both 2024 and 2025. If the related savings were used to reduce the government deficit, as recommended by the Council, those projections would imply a fiscal adjustment of 1,0 % of GDP in 2024, whereas net nationally financed primary expenditure ([19]) provides a contractionary contribution to the fiscal stance of 0,5 % of GDP in that year. The emergency energy support measures have been wound down in 2023 and 2024. This is in line with the Council recommendation. However, the related savings are not projected to be fully used to reduce the government deficit. There is a risk that this will not be in line with the Council recommendation.

(18) In addition, the Council also recommended that Latvia preserve nationally financed public investment and ensure the effective absorption of grants under the Facility and of other Union funds, in particular to foster the green and digital transitions. According to the Commission's 2024 spring forecast, nationally financed public investment is projected to increase from 3,3 % of GDP in 2023 to 3,4 % of GDP in 2024. This is in line with what was recommended by the Council.

(19) On the basis of the policy measures known at the cut-off date of the forecast and on a no-policy-change assumption, the Commission's 2024 spring forecast projects a government deficit of 2,9 % of GDP in 2025. The general government debt-to-GDP ratio is set to increase to 46,3 % by the end of 2025. The increase in the debt-to-GDP ratio in 2025 mainly reflects positive stock-flow adjustment and the government deficit.

(20) Latvia's tax revenue as a share of GDP remains significantly below the Union average, limiting the funding for public services, in particular healthcare and social protection. In 2022, the share of tax revenues decreased to 30,3 % of GDP (compared to 40,2 % of GDP in the Union), the lowest level in the last 3 years. In the fields of taxation less detrimental to growth, in particular capital and property, Latvia still scores below the Union average. Revenue from corporate income tax has been gradually recovering after the sharp downward correction following the 2018 reform, while cadastral reform for property taxation to reflect current market values has not yet been adopted, although work is underway to improve the cadastral valuation methodology. The relatively low revenue from labour taxation, despite relatively high tax rates, suggests that there is potential to increase revenue from labour taxes. This warrants sustained efforts to improve tax compliance and shift economic activity from the shadow economy to the formal economy. Meanwhile, poverty and income inequality remain high in Latvia. Among Union Member States, Latvia has one of the highest percentages of people at risk of poverty and social exclusion, one of the highest risks of poverty for older people, as well as some of the lowest pensions compared to wages. Moreover, income inequality remains significantly above the Union average. Disparities in social support at municipal level, the poor quality and limited availability of existing social housing as well as significant socio-economic differences across regions continue to pose challenges for social inclusion and the labour market. Public spending on healthcare in Latvia

([18]) The figure represents the level of the annual budgetary cost of those measures, including revenue and expenditure and, where applicable, net of the revenue from taxes on windfall profits of energy suppliers.

([19]) This contribution is measured as the change in general government primary expenditure, net of (i) the incremental budgetary impact of discretionary revenue measures, (ii) one-offs, (iii) cyclical unemployment expenditure and (iv) expenditure financed by non-repayable support (grants) under the Facility and other Union funds, relative to the medium-term (10-year) average potential nominal GDP growth rate, expressed as a ratio to nominal GDP.

remains among the lowest in the Union, leading to a high level of unmet healthcare needs and weak health outcomes. In recent years, public spending on healthcare and social support temporarily increased against the backdrop of pandemic emergency support as well as other additional budget allocations on an ad hoc basis. However, the 2024 budget envisages that general government expenditure on healthcare will fall to its 2020 level (4,7 % of GDP) and expenditure on social protection will drop below the 2020 level (12,4 % of GDP planned in 2024, compared to 13,3 % in 2020). Medium-term plans envisage a further reduction of public spending on healthcare, which would hit 4,1 % of GDP in 2028, while public spending on social protection is expected to increase gradually to 13,8 % of GDP in 2028.

(21) In accordance with Article 19(3), point (b), of Regulation (EU) 2021/241 and criterion 2.2 of Annex V to that Regulation, the recovery and resilience plan includes an extensive set of mutually reinforcing reforms and investments to be implemented by 2026. Those reforms and investments are expected to help effectively address all or a significant subset of challenges identified in the relevant country-specific recommendations. Within this tight timeframe, proceeding swiftly with the effective implementation of the recovery and resilience plan, including the REPowerEU chapter, is essential to boost Latvia's long-term competitiveness through the green and digital transitions, while ensuring social fairness. To deliver on the commitments of the recovery and resilience plan by August 2026, it is essential for Latvia to continue the implementation of reforms and investments. The systematic involvement of local and regional authorities, social partners, civil society and other relevant stakeholders remains essential in order to ensure broad ownership for the successful implementation of the recovery and resilience plan.

(22) As part of the mid-term review of the cohesion policy programmes, in accordance with Article 18 of Regulation (EU) 2021/1060 of the European Parliament and of the Council ([20]), Latvia is required to review each programme supported by the European Regional Development Fund (ERDF), the European Social Fund Plus (ESF+), the Cohesion Fund and the Just Transition Fund (JTF) by March 2025, taking into account, among other things, the challenges identified in the 2024 country-specific recommendations, as well as its national energy and climate plan. That review forms the basis for the definitive allocation of the Union funding included in each programme. While Latvia has made progress in implementing cohesion policy programmes and the European Pillar of Social Rights, challenges remain and significant regional disparities persist between the capital city Riga and the rest of Latvia, in particular Latgale in the east. Accelerating the implementation of cohesion policy programmes is crucial. The priorities agreed in the cohesion policy programmes remain relevant. It is important to support the capacity of businesses to innovate and digitalise in order to increase productivity. Supporting energy efficiency measures in buildings and businesses remains a priority. It is equally important to ensure access to timely and equal good quality health services and infrastructure, social services, including social housing, continuing the transition to independent living and community-based care. Activation, reskilling and upskilling of the unemployed and boosting participation in the labour market for under-represented groups remains a priority. Improving the quality and inclusiveness of education together with upskilling and reskilling the adult population should continue. In the context of the mid-term review of cohesion policy programmes, the existing regional disparities and ensuring an adequate level of investment in the field of material deprivation (including food and material assistance) merits specific consideration. Latvia could also use the Strategic Technologies for Europe Platform, established by Regulation (EU) 2024/795 of the European Parliament and of the Council ([21]), to support the transformation of industry, with the focus on smart and renewable energy (e.g. offshore wind energy parks) where there is interest from international investors, as well as knowledge-intensive bioeconomy and biotechnology.

(23) Beyond the economic and social challenges addressed by the recovery and resilience plan and other Union funds, Latvia faces several additional challenges related to the business environment, labour and skills shortages, and the transition to clean energy and a green economy.

([20]) Regulation (EU) 2021/1060 of the European Parliament and of the Council of 24 June 2021 laying down common provisions on the European Regional Development Fund, the European Social Fund Plus, the Cohesion Fund, the Just Transition Fund and the European Maritime, Fisheries and Aquaculture Fund and financial rules for those and for the Asylum, Migration and Integration Fund, the Internal Security Fund and the Instrument for Financial Support for Border Management and Visa Policy (OJ L 231, 30.6.2021, p. 159, ELI: http://data.europa.eu/eli/reg/2021/1060/oj).

([21]) Regulation (EU) 2024/795 of the European Parliament and of the Council of 29 February 2024 establishing the Strategic Technologies for Europe Platform (STEP), and amending Directive 2003/87/EC and Regulations (EU) 2021/1058, (EU) 2021/1056, (EU) 2021/1057, (EU) No 1303/2013, (EU) No 223/2014, (EU) 2021/1060, (EU) 2021/523, (EU) 2021/695, (EU) 2021/697 and (EU) 2021/241 (OJ L, 2024/795, 29.2.2024, ELI: http://data.europa.eu/eli/reg/2024/795/oj).

(24) At 14,9 % of GDP in 2022, business investment in Latvia is somewhat below Estonia's level of 16,5 % of GDP and slightly higher than 13,1 % of GDP in Lithuania. However, levels of net private investment have remained among the lowest in the Union, amounting to 0,5 % over the past 5 years compared to the Union average of 3,5 %. Results from the 2023 Investment Survey of the European Investment Bank suggest that private investment is affected by high uncertainty, the lack of availability of skilled staff and high energy costs. In 2023, 77 % of Latvian firms – one of the highest percentages in the Union – perceived business regulations to be a long-term obstacle to investment. Moreover, bank lending has been weak, acting as a further barrier to business investment. Small and medium-sized enterprises find it particularly difficult to get credit. This is partly due to their higher credit risk, but also due to the high cost of credit, stringent collateral requirements and administrative burden. The banking sector is concentrated, leading to weak competition among banks, which is one of the factors behind the high interest rates. Continued efforts to increase competition in the banking sector, including through greater transparency on interest rates and other costs associated with loans, would foster lending activity over the medium term. Furthermore, public lending and guarantee schemes for strategically important investment areas like the green transition and regional development could increase effective competition in the banking market. In addition, boosting the availability of financing sources other than banking would be helpful for business investment. The shadow economy has been a long-standing problem for the business environment, hindering investment, skills development and, as a result, long-term competitiveness. According to Latvian business organisations, the shadow economy distorts competition and incentivises businesses to remain small. Moreover, the prevalence of the shadow economy and weak company balance sheets are key obstacles to higher business lending, according to Latvia's banks.

(25) Labour and skills shortages are increasing in Latvia. In combination with demographic challenges and the declining working age population, this poses a challenge to the country's competitiveness. In 2023, the biggest labour shortages were in science, technology, engineering and mathematics (STEM), sectors that are highly relevant for productivity gains, as well as in the green and digital transitions. By 2030, the most significant shortages are expected in engineering, manufacturing and construction, science, mathematics and information technology. In addition, Latvia also continues to face shortages in healthcare and social care. 91 % of Latvian companies – above the Union average of 81 % – mention the lack of skilled labour as a barrier to investmentThe low proportion of graduates in technology, engineering and science, and the resulting lack of researchers in those areas, are one of the main barriers to strengthening the Latvian research and innovation capacity, especially in the private sector. High-quality education and training systems aligned with changing labour market needs, well-targeted upskilling and reskilling measures, and better working conditions are key to reducing the labour and skills shortages and improving the competitiveness of the country as well as boosting the digital and green transitions. While recent reforms have made vocational education and training more flexible and attractive, continued efforts are needed to modernise and improve the training offer. To unlock untapped labour supply, training measures need to be accessible, including for low-skilled workers and across regions.

(26) Latvia enjoys one of the highest shares of energy from renewable sources in the Union. This is mostly attributable to power production from hydro plants and the high use of biomass, mainly in the heating sector. There is scope to further diversify the country's renewable energy mix. In 2022 and 2023, Latvia experienced an increase in installed capacity for solar and wind power, but these capacities remain significantly below the levels installed in both Estonia and Lithuania. To increase its share of renewables in final energy consumption, Latvia would benefit in particular from tapping into wind and solar power, and from scaling up production from those sources. Despite some limited action planned under the national recovery and resilience plan, additional efforts are needed to remove remaining barriers in the granting of permits for the construction or installation of wind and solar power generation facilities. Moreover, Latvia could take further action to promote demand-side flexibility, such as energy storage owned by end consumers and participation in distributed energy resources and in balancing and flexibility services. It could also clearly define the roles for certain energy market participants, such as aggregators of small-scale demand. Separately, applications for grid connection permits for renewable energy generation facilities considerably exceed the electricity network's available capacity, which is why the issuing of new permits has been halted since July 2023. This shows that there is scope for further regulatory action.

(27) Latvia's progress towards a circular economy needs to be accelerated in order to meet the Union circular economy goals. Indicators of sustainable economic growth are below the Union average, and the country's material footprint is on the rise. Latvia is an average performer in eco-innovation and would benefit from accelerating the implementation of circular business models and boosting investment in eco-innovation to increase resource

efficiency and competitiveness. Latvia has made progress with its waste management system, but still landfills more than half of its municipal waste.

(28) In view of the close interlinkages between the economies of euro-area Member States and their collective contribution to the functioning of the economic and monetary union, in 2024 the Council recommended that euro-area Member States take action, including through their recovery and resilience plans, to implement the 2024 Recommendation on the euro area. For Latvia, recommendations (1), (2), (3) and (4) help implement the first, second, third and fourth recommendations set out in the 2024 Recommendation on the euro area.

HEREBY RECOMMENDS that Latvia take action in 2024 and 2025 to:

1. Submit the medium-term fiscal-structural plan in a timely manner. In line with the requirements of the reformed Stability and Growth Pact, limit the growth in net expenditure ([22]) in 2025 to a rate consistent with, inter alia, maintaining the general government deficit below the 3 %-of-GDP Treaty reference value and keeping the general government debt at a prudent level over the medium term. Broaden the tax base, including for capital and property, and strengthen the adequacy of healthcare and social protection.

2. Continue with the swift and effective implementation of the recovery and resilience plan, including the REPowerEU chapter, ensuring the completion of reforms and investments by August 2026. Accelerate the implementation of cohesion policy programmes. In the context of the mid-term review of those programmes, continue focusing on the agreed priorities, taking action to better address persistent regional disparities and inequalities, while considering the opportunities provided by the Strategic Technologies for Europe Platform initiative to improve competitiveness.

3. Improve the business environment by reducing the administrative and regulatory burden for companies and improving access to finance for small and medium-sized enterprises, including through public lending and guarantee schemes aimed at facilitating investments of strategic importance and boosting competition in the financial markets. Address labour and skills shortages, in particular in STEM and in other specialisations needed for the green and digital transitions, as well as in the social and healthcare sectors, including through targeted upskilling and reskilling, as well as improved working conditions.

4. Accelerate the deployment of wind and solar energy by improving permit-granting procedures and promoting demand-side flexibility. Foster the transition to a circular economy through eco-innovation and sustainable resource management practices.

Done at Brussels, Luxembourg, 21 October 2024.

For the Council

The President

NAGY I.

([22]) According to Article 2, point (2), of Regulation (EU) 2024/1263, 'net expenditure' means government expenditure net of interest expenditure, discretionary revenue measures, expenditure on programmes of the Union fully matched by revenue from Union funds, national expenditure on co-financing of programmes funded by the Union, cyclical elements of unemployment benefit expenditure, and one-offs and other temporary measures.